COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, MAY 15, 2007

APPLICATION OF

APPALACHIAN POWER COMPANY

CASE NO. PUE-2006-00065

For an increase in electric rates

FINAL ORDER

On May 4, 2006, Appalachian Power Company ("Appalachian," "APCo," or "Company") filed with the State Corporation Commission ("Commission") an application, pursuant to § 56-582 C of the Code of Virginia ("Code") and the Commission's Rules Governing Utility Rate Increase Applications and Annual Informational Filings, 20 VAC 5-200-30, for an increase in electric rates. Appalachian requests an annual increase in base revenues of $225.8 million and proposes a $27.3 million credit to its fuel factor, resulting in an overall increase of $198.5 million in charges to its customers.

On May 30, 2006, the Commission issued an Order for Notice and Hearing and Suspending Rates that directed the Company to provide public notice of its application, established a procedural schedule, and assigned this matter to a Hearing Examiner to conduct further proceedings. The Commission suspended Appalachian's proposed rate increase for a period of 150 days from the date the application was filed, the maximum period permitted under § 56-238 of the Code. As a result, the Company's proposed rates, charges, and terms and conditions of service were permitted by law to take effect for service rendered on and after October 2, 2006, on an interim basis subject to refund with interest.

The Commission's Staff ("Staff") and the following parties participated in this proceeding pursuant to the Commission's Rules of Practice and Procedure and the aforementioned Order for

Notice and Hearing and Suspending Rates: The Kroger Co. ("Kroger"); Old Dominion Committee for Fair Utility Rates ("Old Dominion Committee"); VML/VACO APCo Steering Committee ("Steering Committee"); Wal-Mart Stores East, LP ("Wal-Mart"); Steel Dynamics, Inc. – Roanoke Bar Division ("Steel Dynamics"); Michel King, *pro se*; and Office of the Attorney General, Division of Consumer Counsel ("Consumer Counsel").

Public hearings were held in this matter on November 7 and December 6-13, 2006. The following counsel appeared at one or more of the hearings: Anthony Gambardella, Esquire, Charles E. Bayless, Esquire, Guy T. Tripp, III, Esquire, and Jason T. Jacoby, Esquire, on behalf of APCo; Kurt J. Boehm, Esquire, on behalf of Kroger; Edward L. Petrini, Esquire, on behalf of the Old Dominion Committee; Howard W. Dobbins, Esquire, and Robert D. Perrow, Esquire, on behalf of the Steering Committee; Kristine E. Nelson, Esquire, and Scott DeBroff, Esquire, on behalf of Wal-Mart; Damon E. Xenopoulos, Esquire, and Shaun C. Mohler, Esquire, on behalf of Steel Dynamics; Michel King, *pro se*; C. Meade Browder, Jr., Esquire, Ashley C. Beuttel, Esquire, and D. Mathias Roussy, Jr., Esquire, on behalf of Consumer Counsel; and William H. Chambliss, Esquire, Arlen K. Bolstad, Esquire, and Katharine A. Hart, Esquire, on behalf of the Commission's Staff. Eight public witnesses testified at the hearings.[1]

On February 5, 2007, the following participants filed post-hearing briefs: Appalachian; Kroger; Old Dominion Committee; Steering Committee; Wal-Mart; Steel Dynamics; Michel King, *pro se*; Consumer Counsel; and Staff.

On March 28, 2007, Hearing Examiner Alexander F. Skirpan, Jr., entered a Report that explained the procedural history of this case, summarized the record, analyzed the evidence and issues in this proceeding, and made certain findings and recommendations. The Hearing

[1] Report of Alexander F. Skirpan, Jr., Hearing Examiner, dated March 28, 2007 ("Hearing Examiner's Report"), at 3-4, 26-29.

Examiner "recommended that the Commission increase APCo's base rates by approximately $75.876 million and credit the Company's fuel factor by about $45.254 million, which produces an overall net increase of approximately $30.621 million."[2] The Hearing Examiner's Report included the following findings and recommendations:

> (1) The use of a test year ending December 31, 2005, is proper in this proceeding;
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> (2) APCo's test year operating revenues, after all adjustments, are $1,021,679,803;
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> (3) APCo's test year operating revenue deductions, after all adjustments, are $918,029,934;
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> (4) APCo's test year net operating income and adjusted net operating income, after all adjustments are $103,649,869 and $102,223,519, respectively;
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> (5) APCo's current rates produce a return on adjusted rate base of 5.06% and a return on equity of 4.40%;
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> (6) APCo's current cost of equity is within a range of 9.6% - 10.6%, and the Company's rates should be established based on the 10.1% midpoint of the return on equity range;
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> (7) APCo's overall cost of capital, using the midpoint of the return on equity range and the capital structure as adjusted by Staff, is 7.40%;
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> (8) APCo's adjusted test year rate base is $2,021,702,421;
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> (9) APCo's application requesting additional gross annual base revenues of $225,847,296, and a credit to its fuel factor of $27,290,378, or a net annual increase in revenues of $198,556,918, is unjust and unreasonable because it will generate a return on rate base greater than 7.40%;
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> (10) APCo requires $75,875,512 in additional annual base rate revenues to earn its overall cost of capital;
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> (11) APCo should retain fifty percent of its [off-system sales ('OSS')] margins in base rates and include fifty percent of its OSS margins in its fuel

[2] *Id.* at 1.

factor. APCo's shareholders will be entitled to a ten percent sharing of OSS margins included in the fuel factor;

(12) Due to the proposed change in treatment of OSS margins, APCo requires $75,875,512 in additional gross annual base rate revenues, and a credit to its fuel factor of $45,254,245, or a net increase in annual revenues of $30,621,267;

(13) APCo and Staff's proposed revenue allocation methodology is just and reasonable;

(14) APCo should file permanent rates designed to produce the additional revenues found reasonable using the revenue apportionment methodology proposed by APCo and Staff;

(15) APCo should be required to refund, with interest, all revenues collected under its interim rates in excess of the amounts found just and reasonable herein;

(16) APCo should continue to include the cost of environmental compliance investments in the fixed cost of its generation facilities for cost allocation purposes;

(17) APCo should continue to allocate the cost of OSS margins included in base rates based upon demand;

(18) APCo should design its [Large General Service] rates to maintain current load factor crossover points, and to move rate components closer to cost of service;

(19) APCo should continue its surcharge for sales and use taxes;

(20) APCo should implement its proposed changes to terms and conditions, subject to the revisions proposed by Staff regarding the time period for recovery of billing errors and revisions agreed to by the Company regarding discontinuation of service without notice, and denial and discontinuance of service; and

(21) APCo should be directed to file a new Chapter 4 application for approval of its service company agreement with [American Electric Power Service Corporation ('AEP Service')] within thirty days of the final order in this case.[3]

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[3] *Id.* at 68-70.

On or before April 18, 2007, the following participants filed comments on the Hearing Examiner's Report: Appalachian; Kroger; Old Dominion Committee; Steering Committee; Wal-Mart; Michel King, *pro se*; Consumer Counsel; and Staff. On April 30, 2007, Steel Dynamics filed a Motion for Leave to File and Reply, seeking authority to file a reply to APCo's comments on the Hearing Examiner's Report. On May 2, 2007, the Company filed a response in opposition to Steel Dynamics' Motion for Leave to File and Reply. On May 10, 2007, Consumer Counsel filed a response, noting that Consumer Counsel does not oppose Steel Dynamics' motion provided that such does not delay entry of a final order in this case.

NOW THE COMMISSION, having considered the record, the pleadings, the Hearing Examiner's Report, and the applicable law, is of the opinion and finds as follows. We deny Steel Dynamics' Motion for Leave to File and Reply, having not found good cause to grant leave for the filing of a reply under 5 VAC 5-10-120 C of the Commission's Rules of Practice and Procedure. As set forth below, we adopt in part and modify in part the findings and recommendations in the Hearing Examiner's Report. Our findings herein result in an overall net rate increase of approximately $24.0 million. We find that APCo's requested net increase of $198.5 million does not result in just and reasonable rates.

Code of Virginia

The Hearing Examiner explained that "APCo seeks to increase its base rates pursuant to Virginia Code § 56-582 C, which permits the Company to:"

> petition the Commission, during the period January 1, 2004, through June 30, 2007, for approval of a one-time change in its rates, and if the capped rates are continued after July 1, 2007, such incumbent electric utility may at any time after July 1, 2007, petition the Commission for approval of a one-time change in its rates. . . . Any petition for changes to capped rates filed pursuant to

> this subsection shall be governed by the provisions of Chapter 10 (§ 56-232 et seq.) of this title.[4]

Section 56-582 C explicitly adopts Chapter 10 of Title 56 as the legal standard by which this case is to be decided. As further noted by the Hearing Examiner, "[u]nder Chapter 10, § 56-234 establishes the duty of a public utility to furnish service at 'reasonable and just rates . . . [and] to charge uniformly . . . all persons, corporations or municipal corporations using such service under like conditions.' Similarly, § 56-235 grants the Commission the power to fix 'just and reasonable' rates. Just and reasonable rates are defined in § 56-235.2 A as follows:"

> Any rate . . . shall be considered to be just and reasonable only if: (1) the public utility has demonstrated that such rates . . . in the aggregate provide revenues not in excess of the aggregate actual costs incurred by the public utility in serving customers within the jurisdiction of the Commission, subject to such normalization for nonrecurring costs and adjustments for known future increases in costs as the Commission may deem reasonable, and a fair return on the public utility's rate base used to serve those jurisdictional customers; (1a) the investor-owned public electric utility has demonstrated that no part of such rates . . . includes costs for advertisement, except for advertisements either required by law or rule or regulation, or for advertisements which solely promote the public interest, conservation or more efficient use of energy; and (2) the public utility has demonstrated that such rates . . . contain reasonable classifications of customers. Notwithstanding § 56-234, the Commission may approve, either in the context of or apart from a rate proceeding after notice to all affected parties and hearing, special rates . . . to individual customers or classes of customers where it finds such measures are in the public interest. . . . In determining costs of service, the Commission may use the test year method of estimating revenue needs, but shall not consider any adjustments or expenses that are speculative or cannot be predicted with reasonable certainty. In any Commission order establishing a fair and reasonable rate of return for an investor-owned . . . electric public utility, the Commission shall set forth the findings of fact and conclusions of law upon which such order is based.[5]

[4] *Id.* at 29 (quoting Va. Code § 56-582 C).

[5] *Id.* at 29-30 (quoting Va. Code §§ 56-234, -235, and -235.2 A).

Our discussion herein will follow the structure set forth in the Hearing Examiner's Report. We will first address revenue requirement, and then cost allocation and rate design. Finally, we will rule on Appalachian's new arguments, presented for the first time in its comments on the Hearing Examiner's Report, that: (1) this proceeding must conform to recently enacted changes in Virginia law; and (2) APCo's customers should wait a minimum of six months before receiving any of the refunds required by this Final Order.

Revenue Requirement

The Hearing Examiner separated the revenue requirement issues into four categories: (1) adjustment cut-off date; (2) OSS margins; (3) cost of capital; and (4) other revenue requirement issues. The Company approximated the revenue requirement impact, as to the differences between itself and Staff, of these issues as follows: (1) adjustment cut-off date – $71.8 million; (2) OSS margins – $79.6 million; (3) cost of capital – $26.9 million; and (4) other revenue requirement issues – $7.5 million.[6]

Adjustment Cut-Off Date

As noted above, the applicable Virginia statute states that the revenue requirement determination herein is "subject to ... adjustments for known future increases in costs as the Commission may deem reasonable" and that "[i]n determining costs of service, the Commission ... shall not consider any adjustments or expenses that are speculative or cannot be predicted with reasonable certainty."[7] In addition, the Company states that the Commission's "instructions for Schedule 17 [of APCo's application] provide [as follows:]"

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[6] *Id.* at 30.

[7] Va. Code § 56-235.2 A.

> 'Each adjustment shall be numbered sequentially and listed under the appropriate description category (Operating Revenues, Interest Expense, Common Equity Capital, etc.). Ratemaking adjustments shall reflect no more than the initial *rate year level of revenues, expenses, rate base and capital....* Detailed workpapers substantiating each adjustment shall be provided in Schedule 21.'[8]

The test year[9] in this case, as chosen by APCo, is calendar year 2005. The rate year[10] is October 2006 through September 2007. The Staff, Consumer Counsel, the Old Dominion Committee, and the Steering Committee updated the test year based on actual data through June 30, 2006. In contrast, the Company explains that it "updated some, but not all, costs through the end of [the] 'rate year' in accordance with Schedule 17 of the Commission's Rate Case Rules [and] introduced detailed evidence of certain actual costs incurred after June 30, 2006 and through September 30, 2006, as well as firm commitments to incur further costs through September 30, 2007."[11]

The Hearing Examiner found "that revenue requirements in this case should be based upon audited results through June 30, 2006, as proposed by Staff, Consumer Counsel, the Old Dominion Committee, and the Steering Committee."[12] The Hearing Examiner stated that "[u]nder § 56-235.2 and the long history of its application by the Commission, the emphasis has been on the test year and actual costs. Audits and verification of revenues, expenses, and investments are basic to cost of service regulation and are designed to subject an applicant's

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[8] Appalachian's April 18, 2007 Comments at 30 (quoting the instructions for Schedule 17 of the Commission's Rules Governing Utility Rate Increase Applications and Annual Informational Filings (20 VAC 5-200-30) (emphasis in original)).

[9] *See, e.g.,* Va. Code § 56-235.2 A ("In determining costs of service, the Commission may use the test year method of estimating revenue needs....").

[10] The rate year represents the first year that the new rates will be in effect.

[11] Appalachian's April 18, 2007 Comments at 23.

[12] Hearing Examiner's Report at 33.

operation to scrutiny to provide the Commission with the information necessary to determine just and reasonable rates."[13]

Appalachian objects to this recommendation "because it conflicts with the plain language of Va. Code § 56-235.2 A, ignores the Commission's Schedule 17 in its Rate Case Rules, is based on faulty analysis, and ignores uncontroverted relevant evidence in this case."[14]
On brief, the Company presents a list of eight "Commission rate decisions approving updating cost adjustments such as those presented by the Company in this case."[15] According to the Company, in the eight cases it cites the Commission permitted rate base updates for periods ranging from seven months to 18 months after the end of the test year. In the instant case, APCo requests adjustments for certain actual costs incurred up to nine months after the test year, and for other projected cost increases spanning 21 months beyond the test year.

In addition, APCo asserts that the "Hearing Examiner has misapplied the plain language of [the] statute," in that the language of § 56-235.2 A "shows clearly that there is no requirement that adjustments be based on Staff s 'audited results' of only actual costs."[16] The Company states that the "statute provides specifically for adjustments for 'future increases in costs' which could not be subject to such an audit. Similarly the same statute prohibits adjustments for expenses that 'cannot be predicted with reasonable certainty.' 'Predicted' expenses by definition cannot be 'actual.' Thus the plain language of the statute shows that adjustments are not limited to Staff's 'actual audited' costs."[17] Appalachian argues that the "fact that costs incurred after June 30, 2006

[13] *Id.* at 32.

[14] Appalachian's April 18, 2007 Comments at 23-24.

[15] *Id.* at 37-41.

[16] *Id.* at 24.

[17] *Id.* at 24-25.

were not audited, which is beyond the control of the Company, is no justification under the statute for ignoring those costs in the determination of a revenue requirement in this case. The statute does not require an audit, and the Rate Case Rules do not require an audit. The Company's witnesses who verified the actual expenditures after June 30, 2006 were available for cross-examination. ... The Company has done all it can to verify those expenditures for inclusion in the revenue requirement, and they should be so included."[18] Appalachian concludes that "§ 56-235.2 A requires that [the Hearing Examiner] engage in such an analysis and evaluation to reach a conclusion as to the reasonableness of those costs. Because he failed to do so, the Commission must now engage in that analysis and evaluation based on the evidence regarding those costs that are in evidence in this case."[19]

Upon review of the record, we adopt the Hearing Examiner's recommendation on this issue. We have considered the post-June 2006 adjustments proposed by the Company. We must evaluate these adjustments in terms of establishing just and reasonable rates under the statute, which requires a "demonstrat[ion] that such rates ... in the aggregate provide revenues not in excess of the aggregate actual costs incurred by the public utility in serving customers...."[20] We do not find that APCo's post-June 2006 adjustments are reasonable and will result in just and reasonable rates. APCo has not demonstrated that its aggregate rates will not provide revenues in excess of its aggregate costs if the Commission includes the post-June 2006 adjustments proposed by the Company. Appalachian also has not established that these selective adjustments, for both actual and projected costs, should not be offset by other post-June 2006

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[18] *Id.* at 25.

[19] *Id.* at 26.

[20] Va. Code § 56-235.2 A.

adjustments for increased revenues or decreased costs that have occurred or that can be predicted to occur with reasonable certainty. In addition, we find that APCo's projections, some of which were prepared in the fall of 2005[21] and some of which extend 21 months beyond the test year, are speculative.

Appalachian is correct that the Virginia statute does not mandate, as a precondition to reasonableness, that other parties have a chance to audit and to verify every proposed adjustment. The ability of participants in the case to audit and to verify such adjustments, however, is one means to help establish that the adjustments selected by the Company are reasonable and that such adjustments need not be offset by updating other costs and revenues. Indeed, the Hearing Examiner gives the following example: "[I]n adjusting the test year for a significant increase in vegetation management, it is unclear whether test year sales have been adjusted to reflect a reduction in outages, or other maintenance expenses, materials and supply inventories, or other equipment adjusted to reflect the savings that may be realized from a more aggressive vegetation management program."[22] Appalachian has not shown that its post-June 2006 adjustments to actual 2005 test year results will produce just and reasonable rates that properly align those adjustments with its other costs and revenues.

Finally, we reject the Company's assertion that Schedule 17 somehow requires approval of adjustments proposed through the end of the rate year. Appalachian states that the Commission's Rate Case Rules "require[] utilities to file rate year information on Schedule 17" and further notes that the instructions for Schedule 17 limit ratemaking adjustments to "no more

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[21] *See* Consumer Counsel's April 18, 2007 Comments at 3 n.7.

[22] Hearing Examiner's Report at 33.

than the initial rate year level of revenues, expenses, rate base and capital."[23] Schedule 17 is part of the Commission's Rules Governing Utility Rate Increase Applications and Annual Informational Filings (20 VAC 5-200-30) and, thus, reflects a filing requirement for rate increase applications. These rules permit, but do not mandate, the use of rate year adjustments. The Commission in no manner violates its own rules if adjustments proposed by the Company in Schedule 17 are not approved for ratemaking purposes.

OSS Margins

The Hearing Examiner stated that "[t]here are three issues related to OSS margins: (i) the level of OSS margins that should be considered in this proceeding, (ii) whether OSS margins should remain as a reduction to base rates or become part of the fuel factor or other tracking mechanism, and (iii) whether there should be a sharing of OSS margins between customers and shareholders."[24]

We reject APCo's estimated level of OSS margins. As found by the Hearing Examiner, "APCo has failed to prove that its estimated rate year level of OSS margins is reasonably certain and has failed to show that its actual OSS margins through June 2006, are unreasonably high."[25] We find that the level of OSS margins should reflect actual margins earned through June 30, 2006 and adopt the Hearing Examiner's finding "that Staff's adjusted OSS margins of $100.6 million for the twelve months ended June 2006, should be used in determining revenue requirements in this proceeding."[26]

[23] Appalachian's April 18, 2007 Comments at 30-33.

[24] Hearing Examiner's Report at 36.

[25] *Id.*

[26] *Id.* at 37.

We also acknowledge, as noted by the Hearing Examiner, that ratepayers would receive a larger credit, and thus benefit, if we accepted rate year adjustments for OSS margins beyond June 2006. For example, "actual OSS margins for the twelve months ended September 2006, were more than $26 million higher, on a total APCo basis, or more than 11.6% higher than actual margins for the twelve months ended June 2006."[27] However, as we did above with other proposed adjustments, we again find that it is reasonable to limit test year adjustments to the use of actual, verifiable data through June 30, 2006 to establish the level of OSS margins. Similarly, we reject APCo's $68.2 million estimate for rate year OSS margins, which is "35% lower than jurisdictional margins earned for the twelve months ended September 2006 ($103.9 million)"[28] and "fails to meet the test of being reasonably certain."[29]

We also find that it is reasonable to continue the Commission's existing policy and credit 100% of OSS margins to customers. As argued by the Old Dominion Committee, Appalachian's "fixed costs for OSS sales and trading activities would be included in its revenue requirement, including the costs of AEP's Commercial Operations Department, which consists of capital investment and operating expenses necessary to engage in such sales and trading activities. Similarly, Appalachian's revenue requirement includes its share of the costs of generation and transmission facilities needed to generate and deliver energy subject to the OSS sales and trading activities."[30] We conclude that continuing to reflect 100% of APCo's adjusted test year OSS margins in rates remains consistent with the fact that customers have paid, and continue to pay, the fixed costs incurred to provide the infrastructure used to produce such margins.

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[27] *Id.* at 36.

[28] Consumer Counsel's April 18, 2007 Comments at 6 n.15.

[29] Hearing Examiner's Report at 39.

We further conclude that margin sharing is not required as an additional incentive for Appalachian to maximize OSS margins. As a public utility, APCo: (1) has a public service obligation to optimize use of its generation assets; and (2) is fairly compensated for its share of the costs and risks of producing the margins.[31] We agree with the Old Dominion Committee that "[s]uch 'extra' compensation is not needed to compensate Appalachian for doing what is has agreed to do by virtue of its acceptance of its monopoly franchise."[32] We also note that, under the Commission's prior treatment of OSS margins, "from 2000 to 2005, [the Company's] shareholders retained approximately $180 million in OSS margins otherwise allocable to APCo's Virginia-jurisdictional operations."[33]

We reject the argument that the volatility of OSS margins necessitates different treatment from what we find herein. Although OSS margins may fluctuate on a month-to-month basis, the amount of OSS margins reflected in rates is not based on any one month of data, but rather an adjusted test year. In this regard, the evidence in this case shows that the Company's OSS margins – based on a rolling 12-month average – have not been volatile, but have steadily trended upward since December 2004.[34]

Finally, we find that the level of adjusted test year OSS margins found reasonable herein (*i.e.*, $100.6 million) shall be credited to customers through a separate OSS Margin Rider. We also find that it is reasonable to allocate OSS margins to customer classes based 50% on demand

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[30] Old Dominion Committee's April 18, 2007 Comments at 13-14.

[31] *See, e.g., id.* at 18; Lamm, Exh. 65 at 5.

[32] Old Dominion Committee's April 18, 2007 Comments at 18.

[33] Hearing Examiner's Report at 40.

[34] *See* Lamm, Exh. 66.

and 50% on energy.[35] The Company's temporary system sales rider, which APCo placed in effect on an interim basis and subject to refund during this case, shall terminate upon the effective date of the rates approved in this Final Order, at which time the separate OSS Margin Rider shall become effective.[36]

Cost of Capital

We find that the cost of capital in this case should be based on Staff's *capital structure* as adjusted through June 2006, and a *cost of equity* range of 9.6% to 10.6%, using 10.0% to calculate APCo's revenue requirement.

Capital Structure

The Hearing Examiner explains that "there are two contested issues regarding capital structure. The first pertains to the use of APCo's projected capital structure of September 2007, or Staff's actual capital structure of June 2006. The second issue concerns whether equity should be adjusted to remove undistributed subsidiary earnings."[37]

We find that "Staff's proposed use of a capital structure [as adjusted through] ... historic June 2006 is reasonable and consistent with the use of a rate base as of the same date. Generally, the cost of financing such a rate base reflects the actual capital employed as of that date."[38] In

[35] The participants in this case provide evidence and arguments supporting various OSS margin allocations. Some of the proposals allocate on the basis of demand and some on energy, and some are dependent upon whether OSS margins are collected through fuel factor or base rate calculations. We have established, however, a separate OSS Margin Rider, and we find that a combined demand and energy allocation results in just and reasonable rates for all customer classes.

[36] Accordingly, Appalachian also shall recalculate, using the level of adjusted test year OSS margins (*i.e.,* $100.6 million) and the methodology for allocating OSS margins for customer classes (50% on demand and 50% on energy) found reasonable herein, each customer's share of the approved OSS margins between the date interim rates took effect subject to refund and the effective date of the OSS Margin Rider approved in this case. Appalachian shall credit to customers the resulting increased credit in accordance with the refund requirements set forth in this Final Order.

[37] Hearing Examiner's Report at 43.

[38] *Id.*

addition, "Staff maintained that the Commission has a long history of precedent in the use of an actual capital structure rather than a projected capital structure."[39] We disagree with the Company's assertion that Staff's proposed capital structure "is contrary to the weight of the evidence."[40] Although we find that APCo's proposed capital structure is not reasonable, the Commission does not need to make such finding prior to adopting a June 2006 capital structure. For example, as explained by the Hearing Examiner, "in *Central Tel. Co. of Va. v. Corp. Comm'n.*,[41] the Commission's decision to use the capital structure of the parent of the local utility was upheld, without a finding of unreasonableness of the actual capital structure of the local utility, which was used in the utility's prior case."[42]

Steel Dynamics "proposed an adjustment to the level of equity reflected in the capital structure to remove undistributed subsidiary earnings," which would "reduce the revenue requirement for the Company by approximately $1 million."[43] We agree with the Hearing Examiner that such adjustment is not necessary; the "average cost of capital is an average of all capital, regardless of whether it is used for financing assets devoted to providing utility service or other non-utility assets."[44]

Cost of Equity

The Hearing Examiner explained that the "return on equity recommendations of the experts that testified in this case are as follows: Company witness Moul – 11.0% to 12.0%,

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[39] *Id.*

[40] Appalachian's April 18, 2007 Comments at 23.

[41] 219 Va. 863 (1979).

[42] Hearing Examiner's Report at 43-44.

[43] *Id.* at 42.

[44] *Id.* at 44.

using the midpoint of 11.5%; Staff witness Maddox – 9.4% to 10.4%, using the low end of 9.4%; and Consumer Counsel witness Parcell – 9.5% to 9.75%, with emphasis on the low end. Each of the witnesses based his recommendation on the results of [Discounted Cash Flow ('DCF'), Capital Asset Pricing Model ('CAPM')], and risk premium or comparable earnings models."[45]

We agree with the Hearing Examiner that Mr. Moul's comparable earnings should be given little weight in this proceeding. The Hearing Examiner stated that "I am unconvinced that the risks of the entities chosen by Mr. Moul are comparable to APCo, and I question the selection criteria, especially the use of Value Line's timeliness rank."[46] Mr. Moul's comparable earnings approach attempted "to compare APCo to International Speedway, the Washington Post, and Tootsie Roll Industries."[47]

Mr. Moul's alternative DCF, which is driven by high and low extremes of DCF calculations for a proxy group of companies, also includes Exelon. The Hearing Examiner agreed with Staff "that Exelon is not a good proxy for APCo because it has divested its generation assets and has been involved in proposed mergers."[48] The inclusion of Exelon "increases the upper end of Mr. Moul's zone of reasonableness from 11.19% to 15.08%;" whereas, "[e]xcluding Exelon, Mr. Moul's alternative DCF produces results of about 9.785%."[49]

We also reject APCo's proposed adjustments for (1) leverage (where market value exceeds book value), and (2) flotation costs (for issuance of stock). The Company argued that the "need for the [leverage] adjustment arises because common equity must be sold in the market

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[45] *Id.*

[46] *Id.* at 47.

[47] *Id.*

[48] *Id.*

[49] *Id.*

at a market price while rate making in this case will proceed on the book value of the common equity. This difference means that investors' risk expectations are governed by a capital structure with an equity ratio based on the market price of the stock. ... Investment decisions are made in the market based on the financial risk reflected in market capitalization ratios. If a different set of capitalization ratios are used to set the authorized return on equity, that return does not comport with the risk expectations of investors."[50]

The Hearing Examiner's rejection of the leverage adjustment properly included the following analysis:

> As Mr. Parcell shows in his attached schedules, market value has exceeded book value on utility stocks for many years. If, as Mr. Moul argues, such differences cause distortions in DCF and CAPM results used in the ratesetting process, these distortions should be measurable in some way. Mr. Maddox expressed this sentiment during the hearing:
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> > The [leverage] adjustment, I believe, is unnecessary because the book value is what is used for ratemaking purposes. If, as Mr. Moul would contend, that was insufficient, that investors were not being afforded a reasonable return on that book value, one would expect that they would drive down the prices of those stocks.
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> Furthermore, Mr. Moul's adjustment of *beta*, as reported by Value Line, for his own *beta*, adjusted for leverage, takes his CAPM approach out of the realm of investor expectations. In other words, as Mr. Parcell testified, investors do not have access to leveraged *betas*.[51]

The Hearing Examiner rejected the flotation adjustment because "neither Mr. Moul, nor any other APCo witness, attempted to establish actual costs incurred by the Company in regards to the issuance of common stock. Based on my understanding of the Commission's established

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[50] Appalachian's April 18, 2007 Comments at 15.

[51] Hearing Examiner's Report at 45-46 (citations omitted) (emphasis in original).

policy of permitting flotation costs only where, and to the extent, a utility actually incurs a cost to issue common stock, I find that no flotation adjustment should be made to the cost of equity for such costs in this case."[52] Appalachian responds that the "evidence in this case shows that the Company's parent incurs flotation costs to issue common stock...[, that] APCo's parent has continuing flotation costs...[, and that if] the Commission intends its policy to require evidence of an impending common stock issuance, the policy should be changed."[53] The Hearing Examiner's understanding of the Commission's established policy is correct. No flotation adjustment shall be allowed under the facts of this case.

In addition, as discussed by Staff, "significant biases ... remain embodied in Mr. Moul's analysis," such as (1) his "inappropriate use of projected interest rates that boost his risk premium recommendation," and (2) "the upward bias in Mr. Moul's DCF analysis because his growth rate primarily emphasized projected earnings per share growth rates and ignored other projected rates of growth for dividends, book value, and retained earnings to estimate a long-term sustainable growth rate assumed by the DCF model and reflected in the rates developed by the other witnesses."[54]

We find that a cost of equity ranging from 9.6% to 10.6%, using 10.0% to calculate revenue requirement, results in a fair and reasonable return. Although the Hearing Examiner recommends using the midpoint of this range (*i.e.*, 10.1%) to calculate revenue requirement, we conclude that there is sufficient evidence to utilize a cost of equity that is ten basis points below the midpoint. Staff and Consumer Counsel proposed using the low end of the cost of equity

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[52] *Id.* at 46.

[53] Appalachian's April 18, 2007 Comments at 18.

[54] Staff's April 18, 2007 Comments at 5-6.

range due to the reduced risks inuring to the Company as a result of § 56-582 B (vi) of the Code, which provides Appalachian dollar-for-dollar recovery of certain environmental and reliability costs. The Hearing Examiner found "that the record in this case is too undeveloped to support recommending a lower return on equity based on" the requirements of § 56-582 B (vi) of the Code.[55] We find, however, that the record is sufficiently developed by Consumer Counsel and Staff to justify a ten basis point reduction from the midpoint to reflect the reduced risks resulting from the Company's dollar-for-dollar recovery of certain environmental and reliability costs. In addition, we find credible the testimony of Consumer Counsel witness Parcell and Staff witness Maddox and conclude that the midpoint of their proposed ranges (9.63% and 9.9%, respectively) fall within the zone of reasonableness in this case and, thus, further support using 10.0% for revenue requirement purposes.

<u>Other Revenue Requirement Issues</u>

Customer Growth

We find that "the customer growth adjustment should be based on actual, audited customer growth through June 30, 2006" and, thus, reject Appalachian's request to reflect estimated customer growth through March 2007.[56]

Depreciation

We find that depreciation expense should be based on "Staff's revised depreciation-related adjustments and recommendations" that, among other things, apply the Company's new

[55] Hearing Examiner's Report at 48.

[56] *Id.*

depreciation rates to the June 30, 2006 plant in service "balances as proposed by Staff and Consumer Counsel."[57]

Working Capital

Appalachian did not file a lead/lag study to support its need for working capital. The Hearing Examiner found "that prepayments other than prepaid pensions should be excluded from rate base as APCo has decided against filing a lead/lag study to support a need for working capital."[58] The Hearing Examiner treated prepaid pensions different from other prepayments, "because prepaid pensions are directly tied to reducing operating expenses," and, thus, he "agree[d] with the Company that such prepayments should be included in rate base."[59]

In response, the Company disagreed with part of the Hearing Examiner's findings, arguing that "[b]ased on the evidence of record, the Commission should include *all* prepayments in APCo's rate base."[60] Appalachian asserted that a lead/lag study is not necessary to include prepayments in rate base, noting "that fuel and other materials and supplies inventory, which are akin to prepayments, have historically been included in working capital without a lead/lag study."[61]

Staff also disagreed with part of the Hearing Examiner's findings, arguing that the prepaid pension asset should not be included as a separate rate base item. Staff asserted that "[t]he Company, having chosen not to put its true cash working capital requirements at issue through development and filing of a lead/lag study in this case, should not be rewarded with a

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[57] *Id.*

[58] *Id.* at 49.

[59] *Id.*

[60] Appalachian's April 18, 2007 Comments at 46 (emphasis added).

[61] *Id.*

higher than necessary revenue requirement through the separation of particular items from that study that tend in its favor."[62] Consumer Counsel, Old Dominion Committee, and Steel Dynamics also assert that prepaid pensions should be excluded from rate base.[63]

The Company did not include a lead/lag study, which would have enabled a full look at necessary cash working capital. We find that it is reasonable to exclude prepayments, which represent only part of the cash working capital analysis, from rate base. The Company also has not established that it is reasonable to include *all* prepayments absent a complete lead/lag study addressing other items that may work to reduce rate base. We also agree with the Hearing Examiner that "because prepaid pensions are directly tied to reducing operating expenses, ... such prepayments should be included in rate base."[64]

Obsolete Inventory

We find as follows: (1) Appalachian "has provided sufficient explanation for the usefulness of its inactive and zero usage [materials and supplies ('M&S')] inventory;" (2) Consumer Counsel's proposed adjustment to exclude "inactive or zero usage [M&S] inventory as not being used and useful in the provision of service to customers" is denied; (3) "the write-off of obsolete inventory is related to maintaining adequate inventories to respond to unplanned service interruptions and therefore should be reflected in operating expenses;" and (4) "the test year may include an abnormally high level of obsolete inventory write-off and should be normalized" as recommended by the Hearing Examiner.[65]

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[62] Staff's April 18, 2007 Comments at 2.

[63] Hearing Examiner's Report at 49.

[64] *Id.*

[65] Hearing Examiner's Report at 50-51.

Reorganization Expense

We reject Steel Dynamic's proposed adjustment to eliminate reorganization expense. We find that "that test year severance expenses are not non-recurring. In addition, Staff's adjustment to normalized AEP Service expenses based on actual costs through June 2006, appears to address this issue."[66]

Remodeling Expense

We reject Consumer Counsel's proposed adjustment to normalize test year remodeling expenses based on the three-year average of 2003 through 2005. We find that "the upward trend in actual costs indicates that an adjustment to normalize the test year is unwarranted."[67]

Rate Case Expense

We reject Consumer Counsel's proposed adjustment to limit rate case expense to an annual amount of $109,447, which was derived by normalizing the average cost of Appalachian's four previous base rate cases over three years. We find that "[c]onsidering the age of the Company's four previous base rate cases, ... the methodology proposed by [Consumer Counsel] provides no assurance that it would produce a reasonable level of rate case expense."[68]

Amortization of Generation-Related Regulatory Assets and Tax Adjustments

Appalachian adjusted its amortization period for generation-related regulatory assets in existence at the start of the capped rate period to correspond to such period. Staff contended that the new amortization periods for these assets replaced Commission-approved amortization periods and were never approved by the Commission. We agree with the Company and the

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[66] *Id.* at 51.

[67] *Id.* at 52.

[68] *Id.*

Hearing Examiner that "the proper amortization period for these assets is through the expiration of capped rates."[69]

Gains on Discretionary Sales of Emissions

The Company "excluded all of the gains it received on discretionary sales of emission allowances from its revenue requirement and proposed that any such gains be credited to the Company's environmental and reliability surcharge mechanism," whereas Staff "adjusted the test year to reflect the actual audited gains of about $7.3 million for the twelve months ended June 2006."[70] We "find nothing in the record that indicates the level of gains included in Staff's adjustments is unrepresentative or unusual" and "find that Staff's proposed adjustment for gains on the discretionary sales of emissions should be adopted."[71] Thus, we reject the Company's argument that the "evidence contradicts the Hearing Examiner's finding that the level of gains included in Staff's adjustments will be representative of on-going levels."[72]

PJM Administrative Fees

We adopt "Staff's proposed adjustment for PJM administrative fees, to reflect an additional $350,000."[73]

Public Relations and Membership Dues Expense

We reject Consumer Counsel's request to eliminate $216,978 of public relations expenses, $90,662 for EEI dues, and $79,203 in membership dues expenses for other organizations unrelated to reliability.[74]

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[69] *Id.* at 53.

[70] *Id.*

[71] *Id.*

[72] Appalachian's April 18, 2007 Comments at 46.

[73] Hearing Examiner's Report at 53.

AEP Service Expense

Staff "adjusted AEP Service Expense to reflect actual expenses for the six months ended June 2006," and this adjustment "reduces test year AEP Service Expense by approximately $1.8 million."[75] Consumer Counsel recommended exclusions totaling about $1.0 million related to public relations services, membership dues, advertising, and corporate communications. We agree with the Hearing Examiner that "Staff's adjustment provides a reasonable level of AEP Service Expense and should be adopted."[76]

Vehicle Fuel Expense

The Company "adjusted its vehicle fuel expense to reflect an increase from its test year level cost of $2.45 per gallon to $3.00 per gallon. APCo supported the use of $3.00 per gallon based on contentions that vehicle fuel prices have been and will continue to be subject to volatility, and because rates set in this case may be in effect for an extended period of time."[77] We reject the Hearing Examiner's recommendation and find that the Company's request to increase the test year cost of gasoline to $3.00 per gallon is reasonable.[78]

Charitable Donations

We find, as did the Hearing Examiner, "that Staff's proposed normalization of charitable donations produces a reasonable result and should be adopted."[79] The Company, Staff, and Consumer Counsel normalized APCo's $3.9 million donation to the American Electric Power

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[74] *Id.* at 53-54.

[75] *Id.* at 54.

[76] *Id.*

[77] *Id.*

[78] *Id.* at 55.

[79] *Id.*

("AEP") Foundation during the test year by removing two-thirds of this amount. For the remainder of the test year charitable contributions, Staff's proposed normalization adjustment based on a four-year average is reasonable.

In addition, although "Consumer Counsel pointed out that the Commission has a policy of permitting investor-owned utilities to include only fifty percent of charitable donations in revenue requirements to recognize that shareholders receive the primary benefits of such contributions[,] APCo requested that all of its charitable contributions should be reflected in rates 'given the importance of APCo's involvement in the communities in which it provides service.'"[80] The Hearing Examiner, however, found that APCo has failed to provide sufficient reasons or provide an argument for a change in circumstances that would support a change in the Commission's long-standing ratemaking treatment of charitable contributions. We likewise "agree with Staff and Consumer Counsel that fifty percent of the normalized charitable contributions should be included in the determination of the Company's revenue requirement."[81]

MLR

Staff utilized actual data through June 2006 to calculate APCo's Member Load Ratio ("MLR"). We agree with the Hearing Examiner that "Staff's MLR should be used in this case."[82]

West Virginia State Income Tax Apportionment Factors

Appalachian treats West Virginia state income taxes as the Commission has done in prior APCo cases. Staff, however, treats this issue in accordance with more recent Commission precedent as applied to the natural gas industry. As explained by the Hearing Examiner:

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[80] *Id.* at 55 (citation omitted).

[81] *Id.* at 55.

[82] *Id.* at 56.

> Consistent with the Commission's historic treatment of West Virginia state income taxes for ratemaking purposes, the Company used APCo's stand-alone West Virginia state apportionment factor for calculating the appropriate level of West Virginia corporate net income tax. Staff, consistent with the Commission's order in *VNG* used the income apportionment factors from the income tax returns actually filed by APCo in Tennessee, Ohio, West Virginia, and Virginia to develop the effective state income tax rates to be applied to Virginia jurisdictional taxable income.[83]

The Company "calculated that applying stand-alone apportionment factors to APCo stand-alone taxable income produces a West Virginia state income tax expense of $3,381,158."[84] In contrast, Staff applied a consolidated apportionment factor to APCo's stand-alone taxable income, which results in an expense of $824,845. The Hearing Examiner found that, based on the precedent in *VNG*, Staff's methodology should be used in this case. This resulted in the Hearing Examiner using "a 3.16% effective state income tax rate in the gross revenue conversion factor to calculate his recommended rate increase."[85]

Appalachian responds that "the use of the West Virginia consolidated state apportionment factor in this case would be contrary to the methodology used in APCo's previous rate filings [and] would grossly understate the impact of APCo's participation in the West Virginia consolidated income tax return...."[86] The Company concludes that "[t]o properly determine the Company's revenue requirement, an effective state income tax rate of 5.783%, which is based upon the West Virginia stand-alone apportionment factor ... should be used to determine the

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[83] *Id.* at 56 (citing *Virginia Natural Gas, Inc., For Investigation of Justness and Reasonableness of Current Rates, Charges, and Terms and Conditions of Service in Compliance with Prior Commission Order*, Case No. PUE-2005-00062, Final Order (July 24, 2006) ("*VNG*")).

[84] Hearing Examiner's Report at 56.

[85] Appalachian's April 18, 2007 Comments at 44.

[86] *Id.* at 42.

gross revenue conversion factor in this case."[87] We adopt the Hearing Examiner's recommendation on this issue, which is consistent with our recent precedent in *VNG*.

State Income Tax Expense

The Hearing Examiner excluded deferred fuel-related tax adjustments from the calculation of state income tax expense "because deferred fuel may be positive or negative."[88] The Hearing Examiner did not conclude that the same deferred fuel-related tax adjustment is likely to be recurring on an annual basis. We adopt the Hearing Examiner's recommendation.

Tax Effect of AEP Debt

The Company opposed adjustments to income tax expense made by Staff, Consumer Counsel, and the Old Dominion Committee, which reflected "tax savings available to AEP in the form of interest deductions associated with AEP debt that supports its investment in APCo."[89] The Hearing Examiner adopted such adjustments, finding "that the proposed parent company debt adjustment to income tax expense properly allocates a tax benefit received by AEP, to APCo and is consistent with well-accepted Commission practice."[90]

The Hearing Examiner further explained his finding as follows:

> I agree with [Staff and Consumer Counsel] that each asset is supported by the underlying capital structure. This is why APCo's revenue requirement is determined by multiplying rate base, *i.e.*, the total assets employed by the Company to provide service to customers, by the overall cost of capital. Assignments of specific capital sources to specific assets is both impractical and fails to reflect the realities of capital formation.

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[87] *Id.* at 44.

[88] Hearing Examiner's Report at 57.

[89] *Id.*

[90] *Id.* at 58.

> In addition, as pointed out in briefs filed by Staff, Consumer Counsel, and the Old Dominion Committee, the adjustment to reflect tax savings associated with parent company debts is well-established and has been upheld by the Virginia Supreme Court.[91]

Appalachian responds that its "evidence shows that in this instance the cited general principal does not apply."[92] The Company asserts that the "positions of the Staff, [Consumer Counsel, and Old Dominion Committee] do not comport with the reality of the transactions. The funds in question were lent to the Company by its parent, and no equity infusions were made. ... The capital in question is proven to be debt not equity, and the Company proposes to treat it as debt rather than equity for purposes of calculating its tax expense."[93]

We adopt the Hearing Examiner's recommendation. We also find, contrary to APCo's assertion, that it is reasonable to treat the financing at issue herein as equity.

Interest on Customer Deposits

We agree with the Hearing Examiner that adjustments should be made to interest on customer deposits to reflect the most current interest rate.

Transmission Line and Generating Plant Investment

Michel King "argued for the exclusion of investments and costs related to the construction of the Wyoming-Jackson's Ferry transmission line or the Ceredo generating plant, based on the Company's failure to offer adequate support for the prudence of these investments

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[91] *Id.* at 57-58 (citing *GTE South Incorporated v. AT&T Communications of Virginia, Inc.*, 259 Va. 338 (2000); *Application of GTE South Inc.*, Case No. PUC-1995-00019, 1997 S.C.C. Ann. Rep. 216; *Application of Virginia-American Water Co., For a General Increase in Rates*, Case No. PUE-1995-00003, 1997 S.C.C. Ann. Rep. 333; *Commonwealth of Virginia ex rel. David W. Desmond v. United Water Virginia, Inc.*, Case No. PUE-1997-00544, 1999 S.C.C. Ann. Rep. 389; and *Application of Virginia-American Water Company, For a General Increase in Rates*, Case No. PUE-2003-00539, 2004 S.C.C. Ann. Rep. 395).

[92] Appalachian's April 18, 2007 Comments at 44.

[93] *Id.* at 45.

and because APCo failed to respond appropriately to related interrogatories."[94] The Hearing Examiner rejected this request, finding that "the record of this case contains no evidence to suggest that the Wyoming-Jackson's Ferry transmission line and the Ceredo generating plants are not used and useful in providing service to customers or are otherwise tainted by imprudence of any kind."[95]

Mr. King responded that the "Hearing Examiner erred: a) in assigning a burden of proof regarding the prudency of these investments to Mr. King rather than to APCo; and b) in proceeding upon the theory that a capital project that is 'used and useful' and not 'otherwise tainted by imprudence' meets the various requirements §§ 56-234.3, 56-235.1 and 56-235.3."[96] Mr. King asserts that "[i]t is an established matter of law that the burden of proof in rate cases regarding the prudency of a utility's expenses rests with the utility, not with Staff or respondents."[97] Mr. King quotes the following Commission precedent: "'Va. Code § 56-235.3 imposes on the Company the burden of showing its proposed rate changes to be just and reasonable [and t]hat burden extends to each item of expense.'"[98] In addition, Mr. King contends that the "criteria specifically called out in the relevant statutes (§§ 56-235.1, 56-235.3 and 56-234.3) regarding whether a utility expense is eligible for rate base recovery are that such an expense be 'just', 'reasonable', 'proper', 'efficient', and 'reasonably calculated to promote the maximum effective conservation and use of energy and capital resources.'"[99]

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[94] Hearing Examiner's Report at 58.

[95] *Id.*

[96] Michel King's April 18, 2007 Comments at 2.

[97] *Id.* (citing *Central Tele. Co. v. State Corp. Comm'n*, 219 Va. 863 (1979)).

[98] *Id.* at 3 (quoting *Commonwealth Gas Svcs., Inc.*, Case No. PUE-1986-00031, 88 P.U.R. 4th 533).

[99] *Id.* at 8.

We find that the expenses for the Wyoming-Jackson's Ferry transmission line and the Ceredo generating plant were prudent and satisfy the statutory standards referenced by Mr. King. We note, however, that Mr. King's concerns in this matter are not baseless. There is minimal evidence in the record supporting the prudency of these expenditures. Mr. King states that the Hearing Examiner declared during the hearing that "'it's very clear to me that there hasn't been a prudency review done in this case.'"[100] Mr. King is correct that it is within the Commission's discretion to deny recovery of these costs. We find, nonetheless, that there is sufficient evidence for us to conclude that these expenditures satisfy Virginia statutory requirements. For example, the transmission line in question was previously approved by this Commission,[101] has been constructed in accordance therewith, and, as noted by Mr. King, is currently in service.[102] Although the Company did not provide specific documentation as sought by Mr. King on the expenses related to the Ceredo generating plant, we find credible APCo's assertions, as alluded to by Mr. King, that prior to incurring the generating plant costs the Company "justif[ied] these expenses as less costly than various other alternatives considered, including various conservation programs, energy efficiency programs, demand response programs, expanded use of existing Time-of-Day metering programs, etc."[103]

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[100] *Id.* at 6 (quoting Hearing Examiner, Tr. 801-802).

[101] *Application of Appalachian Power Co.*, Case No. PUE-1997-00766, 2001 S.C.C. Ann. Rep. 366, Order Granting Authority to Construct Transmission Facilities (May 31, 2001).

[102] Michel King's April 18, 2007 Comments at 5.

[103] *Id.* at 6. Although Mr. King asserts that APCo failed to provide requested information, Mr. King did not seek to compel production of information during the discovery period in this case. As explained by the Hearing Examiner in response to Mr. King's argument, after the discovery phase of the case, that APCo failed to respond appropriately to interrogatories, "[t]he remedy for unresponsive answers to interrogatories is to file a motion to compel." Hearing Examiner's Report at 58.

We reaffirm the Commission's expectation, however, that in future proceedings the Company produce sufficient evidence to carry its burden on the prudence of all expenditures, not just the ones discussed by Mr. King herein or raised by a party in a subsequent case; this includes but is not limited to items such as PJM Administrative Fees, public relations expenses, advertising, and generating plant investments.

Jurisdictional Cost Allocation

The Company proposed a six coincident peak ("6-CP") demand allocation methodology to assign generation and transmission-related demand responsibility to each of the jurisdictions that the Company serves.[104] Appalachian "supported use of the 6-CP methodology on the basis that such a methodology recognizes the Company's dual peaking nature and that different AEP-East System companies peak at different times of the year."[105] In contrast, Staff, Consumer Counsel, and the Steering Committee requested continued use of a twelve coincident peak ("12-CP") methodology for jurisdictional cost allocation purposes.[106]

The Hearing Examiner stated "that consistency in jurisdictional cost allocation methodologies to avoid double recovery of costs is the primary concern in choosing between the 12-CP and 6-CP methodologies" and found "that APCo should continue to allocate costs to its Virginia jurisdiction pursuant to the 12-CP methodology."[107] The Hearing Examiner explained that both Staff and Consumer Counsel "pointed out that the 12-CP methodology is used in the Company's other jurisdictions, including West Virginia and FERC, and that use of a 6-CP

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[104] The 6-CP methodology allocates costs based on the demand that occurred at the Company's six highest monthly peaks in demand.

[105] Hearing Examiner's Report at 59.

[106] The 12-CP methodology allocates costs based on the demand that occurred at each of the Company's 12 monthly peaks in demand.

[107] *Id.*

methodology may result in a double recovery of costs. Indeed, both calculated that APCo's proposed 6-CP methodology allocates a higher level of cost to the Virginia jurisdiction than the 12-CP methodology."[108] We adopt the Hearing Examiner's recommendation.

Cost Allocation and Rate Design

The Hearing Examiner separated the cost allocation and rate design issues into three categories: (1) class cost of service; (2) revenue apportionment; and (3) rate design.

Class Cost of Service

Class Demand Allocation Factor

The Company uses a 6-CP demand allocator for its class cost of service study, which the Commission has approved in prior cases. Consumer Counsel opposed the continued use of a 6-CP methodology, arguing that it shifts costs to residential customers and that using 12-CP more reasonably recognizes that power production facilities are needed to serve peak demands throughout the year. Staff, the Old Dominion Committee, and Wal-Mart supported the continued use of 6-CP for this purpose.

The Old Dominion Committee explained that using 12-CP overlooks the fact that APCo's peaks are driven primarily by the three winter and summer months and that such peaks are pronounced when compared to other peaks. We adopt the Hearing Examiner's finding "that APCo should continue to utilize a 6-CP demand allocator for its class cost of service study in this proceeding."[109]

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[108] *Id.*

[109] *Id.* at 61.

Allocation of Environmental Investment Costs

The Hearing Examiner rejected Consumer Counsel's request to allocate the Company's incremental environmental compliance investment costs on the basis of a 50% demand - 50% energy allocation factor. Rather, the Hearing Examiner "agree[d] with the Company and the Old Dominion Committee that environmental compliance investment costs become part of APCo's generating facilities and should be allocated to customer classes [based on demand] as any other fixed generation asset."[110] We adopt the Hearing Examiner's finding.

Allocation of Distribution Costs

Wal-Mart states that APCo uses only demand allocators, as opposed to both demand and customer allocators, in allocating certain distribution plant costs. Wal-Mart's "primary recommendation in this case was to have the Commission require APCo to file, in its next rate case, its [class cost of service study] allocating the distribution costs related to Accounts 364 through 368 utilizing a demand and customer cost component."[111] Wal-Mart explains that these plant accounts are "sometimes referred to as 'distribution line costs'" and include investments "such as poles, towers and fixtures, overhead conductors and devices, underground conduit, underground conductors and devices and line transformers."[112] Wal-Mart "would expect that at least 30% of these costs would be allocated on a customer component and, at the most, 70% on a demand component. This would tend to increase the cost of service to those customer classes that have a larger number of customers who utilize distribution lines."[113]

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[110] *Id.*

[111] Wal-Mart's April 17, 2007 Comments at 5.

[112] *Id.* at 4.

[113] *Id.* at 5.

We find that, in the Company's next rate case, the Commission and case participants should have an opportunity to evaluate the allocation of Accounts 364 through 368 using demand and customer allocators. Accordingly, in its next rate case, APCo shall file a class cost of service study using demand allocators as approved herein and also shall file a class cost of service study using both demand and customer allocators for Accounts 364 through 368 as requested by Wal-Mart.

Revenue Apportionment

The Hearing Examiner recommended that the revenue increase approved in this case be apportioned among customer classes based on the methodology proposed by APCo and explained that "[t]here is general agreement among APCo, Staff, Consumer Counsel, and Wal-Mart that the apportionment of the proposed rate increase among customer classes should follow the Company's proposed apportionment methodology that will move each class toward parity based on the relative rate of return for each class."[114] The Company's methodology was opposed by Kroger and the Old Dominion Committee. In addition, Wal-Mart stated that "APCo's proposed revenue allocation does not result in bringing rates close to cost of service" and "that if the Commission determined less of an increase than APCo's requested amount, [Wal-Mart] recommended that any reduction be first allocated to those customer classes whose rates are above their cost of service and then to all classes based on rate base."[115]

Kroger asserts that, under APCo's approach, "among the subsidy-paying classes, the customer classes that deserve the smallest rate increases would actually receive the largest rate increases, and vice versa [and that this] approach turns cost-based ratemaking on its head and is

[114] Hearing Examiner's Report at 64.

[115] Wal-Mart's April 17, 2007 Comments at 6-7.

inherently unreasonable."[116] Rather, "for the subsidy-paying classes [Small General Service ('SGS'), Medium General Service ('MGS'), Large General Service ('LGS'), and Large Power Service ('LPS')], Kroger recommends that each class receive a rate increase equal to its cost-of-service based-increase plus an approximately equal percentage additional increase in order to fund the Residential subsidy."[117] Kroger states that it proposes "rationale and equitable" rate increases of MGS – 1.80%, LGS – 5.96%, and LPS – 9.71%, whereas the Hearing Examiner proposes increases of MGS – 8.02%, LGS – 7.76%, and LPS – 7.52%.[118]

The Old Dominion Committee states that although the Hearing Examiner does not adopt its recommended approach, "based on the revenue deficiency recommended in the Report, the results of [the Hearing Examiner's] recommended approach to inter-class revenue apportionment are similar to those that would be achieved pursuant to the approach recommended by [the Old Dominion Committee]."[119] The Old Dominion Committee asserts that the Hearing Examiner's "recommended approach would move such rate classes halfway toward 'parity' based on the rate of return for each class relative to the average rate of return."[120] The Old Dominion Committee further states that the Hearing Examiner "appropriately rejects the new methodology proposed by Kroger, which ... would have dramatically and unfairly increased the subsidies paid by the large industrial customers in order, in essence, to *maintain* the subsidy paid to the residential class."[121]

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[116] Kroger's April 18, 2007 Comments at 2.

[117] *Id.* at 3.

[118] *Id.* at 4.

[119] Old Dominion Committee's April 18, 2007 Comments at 39.

[120] *Id.* at 38.

[121] *Id.* at 38-39 (emphasis in original).

We adopt the Hearing Examiner's recommended revenue apportionment, which we find reasonably moves customer classes toward parity and results in just and reasonable rates for all rate classes.

Rate Design

We adopt the Hearing Examiner's recommended rate design. The Hearing Examiner noted that the rate design issues "were resolved by the end of the hearings," except for the matters discussed below.[122]

LGS Rate Design

The Hearing Examiner explained that, according to Kroger: (1) "APCo's proposed rate design for LGS has demand charges below LGS demand cost of service and proposed LGS energy charges above LGS energy cost of service;" and, thus, (2) "the Company's proposal will cause higher load factor LGS customers to subsidize lower load factor LGS customers."[123] Appalachian agreed with Kroger, in theory, but opposed Kroger's request to design LGS rates to reflect demand and energy cost of service. As stated by the Hearing Examiner, APCo "testified that Kroger's proposal will cause the MGS-LGS Secondary load factor crossover point to move from 39% to 43%, which will cause the following problems: (i) customers with load factors around the crossover point would be adversely affected as they were forced to migrate to another rate schedule while high-load factor customers would be benefited; (ii) the migration of customers would change the cost characteristics of the MGS and LGS classes, thereby rendering Kroger's cost-based rates incorrect; and (iii) the Company could experience revenue erosion."[124]

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[122] Hearing Examiner's Report at 64-65.

[123] *Id.* at 65.

[124] *Id.* at 66.

The Hearing Examiner "agree[d] with APCo that it should design MGS and LGS rates to maintain the currently proposed load factor crossover points" and further found that "APCo should be directed to utilize any reductions in the revenue requirement apportioned to LGS to design rates to move closer to cost of service, while maintaining current crossover points."[125] In response, "Kroger recommends adoption of the Report's directive to utilize any reduction in the revenue requirement apportioned to move the LGS demand charge closer to cost-of-service, but recommends that the Commission reject the arbitrary and unduly burdensome requirement that the crossover point between classes cannot change."[126] We find that the Hearing Examiner's recommended rate design, which moves intra-class LGS rates closer to cost of service while maintaining the current cross-over points, appropriately balances the interests of all LGS customers and results in just and reasonable rates for both high and low load factor customers within the rate class.

Sales and Use Tax Surcharge

The Company "currently recovers incremental sales and use tax through a surcharge that became effective September 1, 2004" and "argued that the 2004 Act of the General Assembly that instituted the sales and use surcharge, mandates the existing surcharge and its true-up mechanism."[127] Staff, however, "recommended that the sales and use surcharge be rolled into base rates" and "argued that such treatment is consistent with the elimination of the sales and use

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[125] *Id.*

[126] Kroger's April 18, 2007 Comments at 5.

[127] Hearing Examiner's Report at 66.

surcharge for Roanoke Gas Company, Craig-Botetourt Electric Cooperative, and Columbia Gas of Virginia, Inc."[128]

The Hearing Examiner noted that "2004 Va. Acts Sp. Sess. I, ch. 3, cl.5[129] provides as follows:"

> That notwithstanding any provision of law to the contrary, including § 56-582 of the Code of Virginia, any public utility that is, as a result of the provisions of this act, subject to a sales and use tax on tangible personal property purchased or leased for use or consumption by such utility in the rendition of its public service is hereby authorized to recover from each customer that customer's pro rata share of the public utility's actual expense therefore by means of a *sales and use tax surcharge*. The surcharge shall be subject to *annual review and verification* by the State Corporation Commission in the year subsequent to the surcharge, based on data provided in an annual information filing or other information provided to the State Corporation Commission by such utility; however, such review and verification shall *neither constitute a rate case nor be the subject of a rate case*. If the State Corporation Commission determines that the amount of the surcharge differed from the actual sales and use tax incurred as a result of the provisions of this act, a surcharge adjustment shall be applied in the following year. Any excess in the surcharge shall be refunded to ratepayers as a deduction against the surcharge to be imposed in that subsequent year. Any shortfall in the surcharge shall be recovered through an increase in the surcharge to be imposed in that subsequent year. A surcharge that is allocated on a proportionate basis or according to the allocation factors in the utility's most recent State Corporation Commission-approved cost allocation study shall be presumed valid.[130]

The Hearing Examiner agreed with APCo, finding as follows: "Based on my reading of the above act of the General Assembly, I find that the surcharge and the subsequent annual review

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[128] *Id.*

[129] *See* Editor's note to § 58.1-609.3.

[130] Hearing Examiner's Report at 66-67 (emphasis added).

and adjustments, if necessary, are required. Moreover, the act explicitly states that the surcharge is not to be the subject of a rate case."[131]

In response, Staff asserts "that while the Act does state that, 'the surcharge shall be subject to annual review and verification ... however, such review and verification shall neither constitute a rate case nor be the subject of a rate case,' this language specifically refers only to the review and verification process that can otherwise give rise to a surcharge true-up adjustment. Rolling the surcharge into base rates, when otherwise permitted by the Act, is simply not prohibited by this language."[132] Staff states that APCo "should be directed to cease billing the surcharge, be permitted to collect or refund any under- or over-recovery position as of the date of interim rates in the instant proceeding, and be directed to refund any surcharge billed after that date."[133]

We find that it is reasonable for APCo to continue to recover incremental sales and use taxes through a surcharge in the manner explicitly permitted by the above statute.

Terms and Conditions

We adopt the terms and conditions recommended by the Hearing Examiner, which include but are not limited to the following contested matters: (1) with regard to billing errors, customers will receive refunds for any overbillings made during the prior thirty-six months, and the Company will collect from customers any underbillings made during the prior twelve months; and (2) under the "Denial of Service" provision and the "Discontinuance of Service With Notice" provision of the "DENIAL OR DISCONTINUANCE OF SERVICE" section of the

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[131] *Id.* at 67.

[132] Staff's April 18, 2007 Comments at 3 (footnote omitted).

[133] *Id.*

tariff, APCo will include language to state that service can be denied for prior indebtedness by a previous customer provided that the current applicant or customer occupied the premises at the time the prior indebtedness occurred and the previous customer continues to be an owner or bona fide lessee of the premises.[134]

Affiliates Act Approval

The Hearing Examiner noted that Staff "recommended that 'the Commission direct APCo to file a new Chapter 4 application for approval of its service company agreement with [AEP Service] within 30 days of the Final Order in this case.'"[135] The Hearing Examiner adopted Staff's recommendation.[136] In response, APCo asserts that "[t]here is no reason for such a filing" and that "none is given in the [Hearing Examiner's] Report."[137] APCo also explains that the "Company does not object to working with the Staff to identify any specific concerns with its affiliates agreements and to address them as necessary. The Commission, however, should neither endorse an unsupported implication that there are such specific concerns nor require an affiliate filing without any reason."[138]

Staff witness Carr testified "that the Commission's Order approving the current service agreement between APCo and [AEP Service] is six years old."[139] Mr. Carr further explained as follows:

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[134] Hearing Examiner's Report at 68.

[135] *Id.* at 16-17.

[136] *Id.* at 70.

[137] Appalachian's April 18, 2007 Comments at 47.

[138] *Id.*

[139] Carr, Exh. 54 at 15.

> Since that time, APCo and the energy industry in general have experienced dramatic changes, including the collapse of Enron and the rapid growth of the PJM regional transmission organization. In addition, Staff notes that the current service agreement contains numerous references to the Public Utility Holding Company Act of 1935, which has been repealed, and does not incorporate any of the changes caused by the enactment of the Energy Policy Act of 2005. Finally, Staff notes that the current service agreement includes an 'Other Services' clause, which could be construed to allow APCo and [AEP Service] to add or delete corporate services provided under the service agreement without separate Commission approval. The Commission has consistently denied approval of such open-ended clauses in recent service company orders. Taken together, these factors suggest than an update to the service agreement and to the Commission's regulatory approval is in order.[140]

We adopt Staff's and the Hearing Examiner's recommendation. Appalachian shall file a new Chapter 4 application for approval of its service company agreement with AEP Service within 30 days of the Final Order in this case.

Legislation Enacted in the 2007 Session of the Virginia General Assembly

The Company notes that on "April 4, 2007 the General Assembly approved the Governor's Amendment in the Nature of a Substitute for Senate Bill 1416 and House Bill 3068."[141] Appalachian asserts that this proceeding is governed, in part, by this recently passed legislation. For example, the Company contends that this new legislation must inform our analysis regarding OSS margins, cost of equity, and income tax apportionment. If Appalachian is correct, we acknowledge that application of the new statute to the current proceeding would result in a rate increase that can be estimated to be approximately $47.65 million more than the rate increase we otherwise approve herein.

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[140] *Id.* (footnote omitted).

[141] Appalachian's April 18, 2007 Comments at 8.

We would not typically address a statute that has yet to take effect; however, since Appalachian has asserted that the new statute applies, at least in part, to this case, we are compelled to address APCo's assertions in this opinion.

The Constitution of Virginia provides that bills passed by the General Assembly and signed by the Governor shall become effective the following July 1, unless enacted as emergency legislation.[142] Furthermore, it is a standard rule of statutory construction in Virginia that legislation applies prospectively absent an express provision to the contrary.[143] Accordingly, and as further discussed below, we reject APCo's claims that our findings in the instant case must be modified as a result of the recently enacted statute.

OSS Margins

Appalachian asserts that this new statute "adds a new § 56-249.6.D.1 to the fuel factor statute" and "will take effect July 1, 2007 (Va. Const., Art. IV, §13), so beginning July 1, 2007 OSS margins must be used as provided in § 56-249.6.D.1."[144] APCo states that new § 56-249.6.D.1 provides as follows:

> 1. Energy revenues associated with off-system sales of power shall be credited against fuel factor expenses in an amount equal to the total incremental fuel factor costs incurred in the production and delivery of such sales. In addition, 75 percent of the total

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[142] Va. Const. Art. IV, § 13 ("All laws enacted at a regular session, including laws which are enacted by reason of actions taken during the reconvened session following a regular session, but excluding a general appropriation law, shall take effect on the first day of July following the adjournment of the session of the General Assembly at which it has been enacted; ... unless in the case of an emergency (which emergency shall be expressed in the body of the bill) the General Assembly shall specify an earlier date by a vote of four-fifths of the members voting in each house....").

[143] *See, e.g., Washington v. Commonwealth of Virginia*, 216 Va. 185, 193, 217 S.E.2d 815, 823 (1975) ("The general rule is that statutes are prospective in the absence of an express provision by the legislature. Thus when a statute is amended while an action is pending, the rights of the parties are to be decided in accordance with the law in effect when the action was begun, unless the amended statute shows a clear intention to vary such rights." (citing *Burton v. Seifert Plastic Relief Co.*, 108 Va. 338, 350-51, 61 S.E. 933, 938 (1908)).

[144] Appalachian's April 18, 2007 Comments at 8-9.

> annual margins from off-system sales shall be credited against fuel factor expenses; however, the Commission, upon application and after notice and opportunity for hearing, may require that a smaller percentage of such margins be so credited if it finds by clear and convincing evidence that such requirement is in the public interest. The remaining margins from off-system sales shall not be considered in the biennial reviews of electric utilities conducted pursuant to § 56-585.1. In the event such margins result in a net loss to the electric utility, (i) no charges shall be applied to fuel factor expenses and (ii) any such net losses shall not be considered in the biennial reviews of electric utilities conducted pursuant to § 56-585.1. For purposes of this subsection, 'margins from off-system sales' shall mean the total revenues received from off-system sales transactions less the total incremental costs incurred....[145]

APCo concludes that: (a) the new statute "will control the use of OSS margins beginning July 1, 2007, so the conflicting recommendation in the Hearing Examiner's report *must be rejected*;" (b) the "statutory 75% OSS margin sharing should be applied to the period October 2, 2006 through December 31, 2007 via a revised Temporary Sales Rider and 'trued-up' to actual OSS margins for that period as part of the Company's 2008 fuel factor proceeding;" (c) "[i]n annual fuel factor cases the Commission should use estimated annual OSS margins, as well as fuel costs, with later 'true-up' to actual amounts, not previously realized OSS margins which would create a gap in OSS credits to customers prior to December 31, 2007;" and (d) "[u]se of the revised Rider as described in [(b)] above makes unnecessary any revision of the current fuel factor as of July 1, 2007."[146]

We reject APCo's arguments. The new statute does not become effective until July 1, 2007. In addition, APCo's quote, above, of the new statute omits the language that immediately precedes new § 56-249.6.D.1. Specifically, § 56-249.6 D begins with this phrase: "D. In

[145] *Id.*.

[146] *Id.* at 15 (emphasis added).

proceedings under subsections A and C:". The instant case is not a proceeding under subsections A and C of § 56-249.6; rather, Appalachian initiated this rate case pursuant to § 56-582 C of the Code. We agree with the legal analysis provided by the Attorney General, who in addition to serving as Consumer Counsel is the chief legal officer of the Commonwealth: "This [new] legislation does not become effective until July 1, 2007, and thus has no bearing on the question and does not in any way bind the Commission in this case. Moreover, the measures prescribed in this legislation apply only to 'proceedings under subsections A and C' of Virginia Code § 56-249.6. The new law does not apply to Appalachian's off-system sales margins until the Company's next fuel factor proceeding following the legislation's July 1, 2007, effective date."[147]

Likewise, we reject Appalachian's assertion that the new statute dictates the form of any rider established to credit OSS margins to customers. As explained above, we have established a separate OSS Margin Rider based on the law and facts applicable to this proceeding. The manner in which that OSS Margin Rider is, or is not, impacted in any subsequent case under the new law will be determined in that subsequent case.

As argued by APCo, however, we acknowledge that application of the new statute to this case would significantly increase the Company's revenue requirement. For example, under the OSS margin treatment found reasonable in this case by the Commission, customers receive a credit of $100.6 million. In contrast, under the Company's interpretation of the new statute, which Appalachian asserts should govern this case, customers would receive a credit of 75% of $100.6 million, or $75.5 million. Thus, if we applied the new statute to the current proceeding – as and in the manner requested by APCo – the Company's customers would see their rates increased by an additional $25.1 million over the rates approved herein.

[147] Consumer Counsel's April 18, 2007 Comments at 5 n.12.

Cost of Equity

APCo also points to newly enacted SB 1416 and HB 3068 to support its proposed cost of equity. Appalachian states that the new legislation, in part, directs as follows:

> In such proceedings the Commission shall determine fair rates of return on common equity applicable to the generation and distribution services of the utility. In so doing, the Commission may use any methodology to determine such return it finds consistent with the public interest, but such return shall not be set lower than the average of the returns on common equity reported to the Securities and Exchange Commission for the three most recent annual periods for which such data are available by not less than a majority, selected by the Commission as specified in subdivision 2 b, of other investor-owned electric utilities in the peer group of the utility, nor shall the Commission set such return more than 300 basis points higher than such average. 2007 Va. Acts c. 933, § 56-585.1 A.[148]

The Company asserts that: (1) the "new law will create a floor on return on equity that is likely to be higher than the return recommended in the [Hearing Examiner's] Report;" (2) the Hearing Examiner's recommendation "does not adequately reflect ... the intent of the new statutory provisions;" and (3) "[w]hile the record in this case does not contain an express analysis of return on equity calculations under the new legislation, there is evidence that the reported returns in other states to which the new statute refers will likely be in the range recommended by [Appalachian witness] Moul of 11% to 12%."[149]

We have no factual basis to disagree with Appalachian's conclusion regarding the likely results of the new statute, if it were applied to this case. Indeed, a sample calculation of the average returns on common equity derived from reports filed with the Securities and Exchange Commission ("SEC"), for the three-year period 2004-2006, of potential peer utilities as reflected

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[148] Appalachian's April 18, 2007 Comments at 21.

[149] *Id.* at 21-22.

in the new statute is 11.55%.[150] If the two utilities with the lowest return and the two utilities with the highest return are removed as reflected in § 56-585.1 A 2 b of the new law, the resulting return is 11.88%. These results are consistent with Appalachian's assertion that the peer utilities referenced in the new statute support Mr. Moul's recommended return of 11% to 12%. Thus, if we applied the midpoint of Mr. Moul's recommended range of return (*i.e.*, 11.5%) in this proceeding – as opposed to 10.0% as found reasonable herein – APCo's customers would see their rates increased by an additional $19.95 million over the rates approved in this case.[151]

For the reasons discussed above, however, Appalachian is incorrect that the new statute should inform this case. As explained above, based on the record developed in this proceeding, we find that a cost of equity ranging from 9.6% to 10.6%, using 10.0% to calculate revenue requirement, results in a fair and reasonable return for both the Company and its customers.

West Virginia State Income Tax Apportionment Factors

We adopted, above, Staff's and the Hearing Examiner's recommendation to use the income apportionment factors from the income tax returns actually filed by APCo in Tennessee, Ohio, West Virginia, and Virginia to develop the effective state income tax rates to be applied to Virginia jurisdictional taxable income. The Company, however, explains that SB 1416 and HB 3068 recently codified APCo's position "on this issue by amending § 56-235.2 A of the Code of Virginia. That section will now provide in pertinent part ... that APCo's 'apportioned state

[150] The following peer utilities were used for this example, with common equity returns based on reports filed with the SEC: Monongahela Power Company (5.87%); Entergy Mississippi, Inc. (9.59%); Tampa Electric Company (10.24%); Cleco Power (10.87%); FP&L Company (11.31%); Gulf Power (12.00%); Progress Energy Florida, Inc. (12.14%); Alabama Power (13.18%); Georgia Power (13.44%); Mississippi Power (13.71%); and Progress Energy Carolinas, Inc. (14.67%). The peer utilities, calculations, and comparisons in this Final Order do not represent findings of fact but are for illustrative purposes in addressing Appalachian's assertions and do not serve as precedent for implementation of any part of the new statute.

[151] This revenue requirement increase is estimated as follows: $831,142,082 (Common Equity Capital, Hearing Examiner's Report at Attachment 1, Line 28) x 1.5% (increased return on equity, 11.5% minus 10.0%) ÷ 0.624876 (Revenue Conversion Factor for taxes and accounts receivable factoring) = $19,951,368.

income tax costs shall be calculated according to the applicable statutory rate, as if the utility had not filed a consolidated return with its affiliates....'"[152] Appalachian states that "[a]lthough this new statute is not effective until July 1, 2007, its legislative intent is clear. The statute rejects the Hearing Examiner's recommendation to use a consolidated state apportionment factor."[153]

If we agreed to APCo's request, customers would see their rates increased by an additional $2.6 million over the rates approved in this case.[154] We are not bound, however, by a statute that is not yet in effect.

Rates and Refunds

Finally, the Company argues that: (1) its customers should continue to be charged APCo's higher rates currently in effect, which we have found unjust and unreasonable, for a *minimum* of two more months after the date of this Final Order; and (2) its customers should wait a *minimum* of six months before receiving any credits or refunds owed to them by APCo.

Specifically, the Company "requests that it be given a minimum of sixty (60) days from the date of a Final Order to prepare a compliance cost-of-service and to file rates designed to produce the revenue found reasonable by the Commission."[155] In addition, "[d]ue to the expected volume of calculations and the complexity of rebilling the unbundled rates, the Company requests that it be given a minimum of one hundred twenty (120) days from the date the Commission approves its compliance tariff to complete any customer refunds ordered by the Commission."[156]

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[152] Appalachian's April 18, 2007 Comments at 43 (emphasis omitted).

[153] *Id.*

[154] *Id.*

[155] *Id.* at 48.

[156] *Id.* at 49.

Appalachian's request in this matter is entirely unjustified. The Company's customers have endured three rate increases over the past year, which include paying significantly higher rates as a result of APCo's request in this case. Now that the Commission has rejected a large portion of Appalachian's most recent rate hike, the Company seeks to prolong this episode another six months – at a minimum. We find that such request is not just and reasonable and not in the public interest, and, indeed, that APCo's customers deserve better treatment than the Company wishes to impose upon them. We will require that the Company charge new rates, in accordance with the findings made herein, for bills rendered on and after thirty (30) days from the date of this Final Order, and that the Company effectuate refunds (with interest computed as set forth below) within ninety (90) days from the date of this Final Order.[157]

Accordingly, IT IS HEREBY ORDERED THAT:

(1) The findings and recommendations of the March 28, 2007 Hearing Examiner's Report are adopted in part and modified in part as set forth herein.

(2) Appalachian shall forthwith file revised tariffs and terms and conditions of service with the Commission's Division of Energy Regulation, in accordance with the findings made herein, for bills rendered on and after thirty (30) days from the date of this Final Order.

(3) Appalachian shall recalculate, using the rates and charges approved herein, each bill it rendered that used, in whole or in part, the rates and charges that took effect under bond and

[157] This is consistent with prior Commission cases in which new rates and refunds (with interest computed using the average prime rate) were required to be implemented within a 90-day window. *See, e.g., Application of Appalachian Power Co. for an expedited increase in base rates*, Case No. PUE-1994-00063, 1996 S.C.C. Ann. Rep. 255, 257, Final Order (May 24, 1996) (requiring refunds on or before July 26, 1996); *Application of Appalachian Power Co. for an alternative regulatory plan*, Case No. PUE-1996-00301, 1999 S.C.C. Ann. Rep. 367, 368, Final Order (Feb. 18, 1999) (requiring revised tariffs to be filed by March 1, 1999 and refunds to be made by May 18, 1999); *Application of Washington Gas Light Co.*, Case No. PUE-2003-00603, 2004 S.C.C. Ann. Rep. 411, 413, Final Order (Sept. 27, 2004) (requiring new rates to be implemented "commencing with the October 2004 monthly billing cycle" and refunds to be made "within 90 days of the issuance of this Final Order"); *Application of Atmos Energy Corporation for an increase in rates*, Case No. PUE-2003-00507, S.C.C. Ann. Rep. 322, 323 (Jan. 7, 2005) (requiring refunds "within ninety (90) days of the entry of this Order").

subject to refund on and after October 2, 2006 and, where application of the new rates results in a reduced bill, refund the difference with interest as set out below within ninety (90) days of the issuance of this Final Order.

(4) Interest upon the ordered refunds shall be computed from the date payments of monthly bills were due to the date each refund is made at the average prime rate for each calendar quarter, compounded quarterly. The average prime rate for each calendar quarter shall be the arithmetic mean, to the nearest one-hundredth of one percent, of the prime rate values published in the Federal Reserve Bulletin or in the Federal Reserve's Selected Interest Rates (Statistical Release H.15) for the three months of the preceding calendar quarter.

(5) The refunds ordered herein may be credited to current customers' accounts (each refund category shall be shown separately on each customer's bill). Refunds to former customers shall be made by check mailed to the last known address of such customers when the refund amount is $1 or more. Appalachian may offset the credit or refund to the extent of any undisputed outstanding balance for the current or former customer. No offset shall be permitted against any disputed portion of an outstanding balance. Appalachian may retain refunds to former customers when such refund is less than $1. Appalachian shall maintain a record of former customers for which the refund is less than $1, and such refunds shall be promptly made upon request. All unclaimed refunds shall be subject to § 55-210.6:2 of the Code of Virginia.

(6) On or before September 30, 2007, Appalachian shall deliver to the Divisions of Public Utility Accounting and Energy Regulation a report showing that all refunds have been made pursuant to this Final Order, detailing the costs of the refunds and the accounts charged.

(7) Appalachian shall bear all costs incurred in effecting the refund ordered herein.

(8) Steel Dynamics' Motion for Leave to File and Reply is denied.

(9) The Company is ordered to comply with the directives set forth in this Final Order.

(10) This case is dismissed.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to: the attached service list.

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